

RESIDENTIAL MARKET
UPDATE.

Knight Frank



JANUARY 2011

THE OUTLOOK FOR 2011.



"As we enter the new year there is much to be relieved about regarding the UK housing market. Prices rose (slightly) in 2010 and the volume of sales while not spectacular was at least consistently higher than the level seen during the crash. The concerns for this year relate to weak growth in real incomes and declining consumer confidence, but the real issue is the ongoing difficulty large numbers of prospective buyers have in accessing the mortgage market. This issue of access to debt is likely to be the critical factor determining market performance in 2011."

Liam Bailey, Head of Residential Research, Knight Frank

"The division in the UK market, between an equity-rich top tier and a more financially stretched lower tier, looks set to continue into 2011."

The situation now

As we reported last month the relatively strong run that the UK housing market had enjoyed from early 2009, ended in mid-2010. Prices in the mainstream market began to fall from the early summer and on most measures have kept falling – albeit slowly. In fact price rises in the first half of 2010 largely offset the falls in the second half of the year, meaning that prices were higher by 0.4% over the year as a whole.

The apparent health of the market in 2009, masked some significant problems. The main one being that the volume of house sales has continued to stagnate. Mortgage approvals for house purchases had been rising steadily from their low point of 27,000 in November 2008 to hit 59,000 in November 2009. Since this point mortgage lending has actually fallen back, hitting 48,019 approvals in November 2010. Although it should be noted the November total marked a rise after a succession of small declines in previous months.

The division in the UK market, between an equity-rich top tier and a more financially stretched lower tier, looks set to continue into 2011. The real potential for tighter regulations surrounding the mortgage market suggests there is even scope for this division to widen as the year progresses.

The outlook for this year

The three main issues for the market in 2011 are falling household incomes, mortgage market restrictions and the risk of rising interest rates.

Declining real incomes, which stem from the negative impact of rising taxes and stubbornly high inflation, are not being offset by strong wage rises. Instead, an increasing number of employees are facing pay freezes or below inflation rises.

In terms of lending restrictions, with the mortgage market seemingly unable to expand in terms of the volume of lending available - we expect to see the mortgage lenders continue to target the affluent by maintaining the very wide differential in lending rates between the low rates offered to those with deposits of 25% or more and the much higher costs passed on to those with limited equity.

If ongoing strong inflation continues into 2011 this will force the Bank of England to raise interest rates before the mortgage lenders are able to increase their narrow margins significantly. This will not only hamper the sales market - but also cause problems for existing owners, many of whom have been benefitting from very low variable rate mortgages.

JANUARY 2011 RESIDENTIAL MARKET UPDATE.



"The Eurozone crisis has driven new demand from European buyers, looking for the perceived "safe-haven" investment in the central London property market."

Additional risks to watch include mortgage market funding limitations. As we note above this is still a tight market in terms of available funds for lending - it could well get tighter as the Special Liquidity Scheme (emergency government lending to the mortgage sector) begins to be wound down in early 2011.

Prime market performance

The reversal of price falls, which began in November last year, continued through December, with a rise of 1.3% recorded over the month. This most recent price rise means that prices ended the year higher by 10.3% compared to December 2009.

Prices at the end of December were 26% higher than the market low reached in March 2009. Despite this rise, prices are still 4.4% below their March 2008 peak level.

The central London residential market continues to outpace the weakening UK market. Prices, which were falling in the middle of the year, appear to have turned a corner and have now risen noticeably for two consecutive months.

The drivers for this strength in performance are, firstly, strong demand (buyer registrations in the final three months of 2010 were 18% higher than the same period in 2009) set against weak supply: the volume of available properties was only 5% higher in December than in December 2009.

This strong demand has been underpinned by the ongoing weak pound – still delivering effective discounts of 25% for dollar-based buyers, when compared to London property pricing at the peak of the market in 2008.

Added to this, the Eurozone crisis has driven new demand from European buyers, looking for the perceived "safe-haven" investment in the central London property market – with European purchaser registrations rising 25% in the final three months of last year on a year-on-year basis.

In short, the central London market is continuing to buck the wider UK trend of weaker sales volumes and prices. The ability for this trend to continue depends very much on the unique factors in London continuing to play out in favour of the marketplace.

London rental performance

Central London residential rents rose a further 2.2% in the final quarter of 2010. This rise means that rents have risen by 16% over

2010 as a whole and by 19% since their low point reached in mid-2009 when the market was suffering from significant over supply.

Rents are now 5% below the peak level they hit in March 2008 before the impact of the credit crunch was fully reflected in the market.

The main narrative in the London rental market for the last 18 months has been thin supply meeting strong demand, and this was how the year ended.

The volume of available rental properties across the year was 20% lower than in 2009, and - even more strikingly - down by 36% compared to 2008. Set against this reduced supply was the fact that the volume of prospective tenants fell only marginally (by 1%) compared to 2009, but actually rose by 10% compared to 2008.

Why has the rental market seen such demand from tenants? Two reasons stand out. Firstly, employment conditions in central London are much healthier than they were in 2009. Morgan McKinley, the City recruiter, noted that the number of new positions advertised in the central London financial and business services sector rose by 9% in November 2010 compared to November 2009.

Secondly, in addition to the strength of London's employment market – the fact that the sales market is still struggling to create stable growth in the number of deals means that many prospective buyers are still locked out of owner-occupation and have to consider rental as the alternative. Central London sales are still outperforming the UK market, but even here volumes in 2010 were 36% lower than in 2007.

With landlord investments delivering 3.5% yields, together with capital growth of 10.3% in 2010, we should expect more investors to be drawn into the market – indeed, there has been a steady growth of demand for property from investors over the past 18 months. But outside of the new-build sector there are few opportunities for new entrants to convert their interest into purchases.

Summary

We are unlikely to see strong capital growth in any residential sector in 2011. Despite this, interest in residential property from investors is growing. The key reasons are related to improving yields, rents have been rising steadily over the past two years, especially in southern England and London, and also supply and demand dynamics.

JANUARY 2011 RESIDENTIAL MARKET UPDATE.



"Demand for accommodation in most parts of the UK outpaces supply and this situation is set to become more extreme over the short-term."

2011 will be the third consecutive year when new-build development volumes will struggle to reach even 50% of their 2007 peak level. The NHBC New Housing Pipeline Report shows that through 2010 there has been a steady fall in permissions granted for new homes, with a sharp drop in England from more than 40,000 permissions in Quarter One to just 31,553 in Quarter Three.

Demand for accommodation in most parts of the UK outpaces supply and this situation is set to become more extreme over the short-term. This is a key reason why affluent investors are continuing to add properties to their portfolios.

For those with access to equity this year, there will be considerable opportunities in the market in 2011. For the investor these opportunities will be centred on strong yielding properties and refurbishment projects, whilst for developers it will be developing small to medium-sized sites with a product targeting owner-occupiers and longer-term investors.

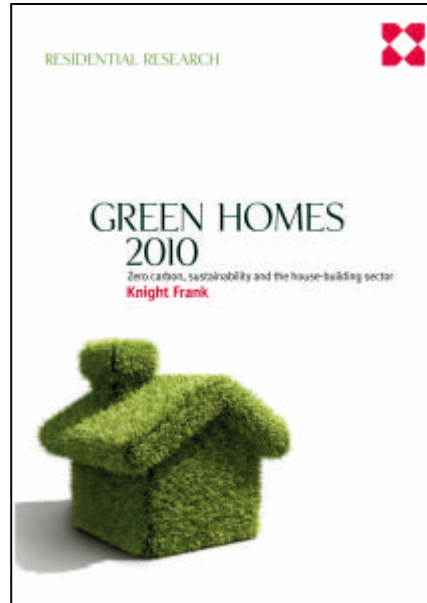
JANUARY 2011 RESIDENTIAL MARKET UPDATE.



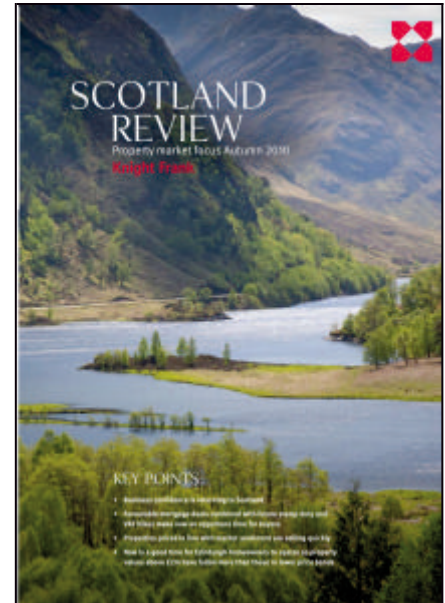
Recent market leading research publications



View the [London Review Autumn 2010 PDF here](#)



View the [Green Homes 2010 PDF here](#)



View the [Scotland Review Autumn 2010 PDF here](#)

Contacts



Liam Bailey
Head of residential research
liam.bailey@knightfrank.com
T +44 (0)20 7861 5133
M +44 (0)7919 303148



Andrew Shirley
Head of rural property research
andrew.shirley@knightfrank.com
T +44 (0)20 7861 5040
M +44 (0)7500 816217



James Kennard
Research consultancy
james.kennard@knightfrank.com
T +44 (0)20 7861 5134
M +44 (0)7500 065142

Knight Frank

Knight Frank Residential Research provides strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, funding organisations, corporate institutions and the public sector. All our clients recognise the need for expert independent advice customised to their specific needs.

Knight Frank Research Reports are also available at KnightFrank.co.uk

© Knight Frank LLP 2011

This report is published for general information only and not to be relied upon in any way. Although high standards have been used in the preparation of the information, analysis, views and projections presented in this report, no responsibility or liability whatsoever can be accepted by Knight Frank LLP for any loss or damage resultant from any use of, reliance on or reference to the contents of this document. As a general report, this material does not necessarily represent the view of Knight Frank LLP in relation to particular properties or projects. Reproduction of this report in whole or in part is allowed with proper reference to Knight Frank Residential Research. Knight Frank LLP is a limited liability partnership registered in England with registered number OC305934. Registered office: 55 Baker Street, London, W1U 8AN.